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RESEARCH:
REGIONAL BANK PARTNERSHIPS
A Paradigm Shift in Direct Lending?

PHOENIX MERCHANT PARTNERS

JUNE 2026

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Summary

This report examines how regional bank–private credit lending partnerships may represent a new paradigm in direct lending. We review the current market structure, concentrated in PE-sponsor backed segments of the economy and discuss how the bank partnership model can help address challenges around diversification, portfolio overlap, and capital crowding.

The paper covers the following aspects:

1. A review of the Commercial and Industrial (C&I) private credit landscape, with a focus on institutional portfolios and structural challenges facing the asset class
2. An introduction of the regional bank lending channel, its origination model, capacity constraints, and the opportunity within underserved segments of the regional economy
3. An overview of bank–private credit partnerships, including their benefits to stakeholders and scalability framework
4. An analysis of how bank-sourced portfolios can enhance diversification and improve portfolio construction within a direct-lending strategic asset allocation (SAA)

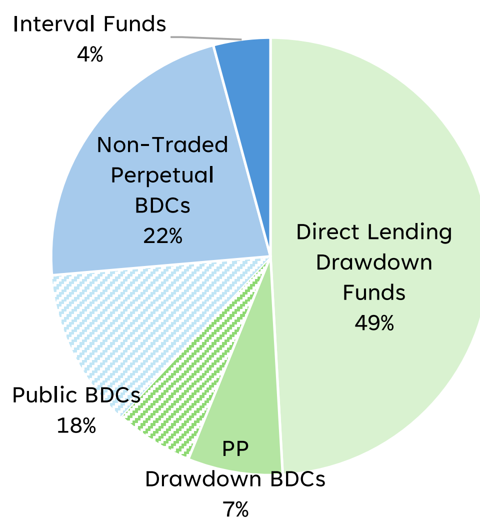
We conclude that a SAA framework that balances sponsor-driven and bank-sourced credit can capture the diversification benefit of these complementary lending strategies, enhancing the risk-return efficiency of direct-lending portfolios.

Commercial & Industrial Private Credit

Non-bank C&I direct lending assets in North America have grown to more than $1.0 trillion by H1-2026[1] across both fund vehicles and BDCs, of which an estimated ~60% is attributable to institutional assets (*see Figure 1*). Institutions include pensions funds, life insurance, sovereign wealth funds, endowments/foundations and family offices, which allocate to the asset class to capture enhanced fixed-income returns, generate stable income, and better match long-term liabilities.

Figure 1: **U.S. C&I Private Credit**

	AUM H1-2026
Direct-Lending DD Funds	$530bn
Private Placement DD BDC	$75bn
Public BDC	$190bn
Non-Traded Perp. BDC	$235bn
Interval/Tender Funds	$45bn
Institutional Assets	63%
Retail Accessible	37%



Sources: Preqin, Houlihan Lokey, XA Investments, PMP Research

Asset growth has been concentrated among a small group of private credit firms, ten of which collectively manage an estimated 70% (~$700 billion) of all C&I direct lending assets[2]

[1] Preqin Global Report: "Private Credit in 2026", Dec-2025

[2] Considers: Ares Mgmt., Blackstone Credit, Blue Owl, HPS/BLK, Golub, MidCap Financial, FS KKR, Sixth Street, Carlyle Credit, GSAM

Challenges for Institutional Portfolios

Direct lending is well aligned with the requirements of institutional investors and has become an established component of strategic asset allocation ("SAA"). As the asset class scales, however, structural challenges are emerging, including

- **Diversification:** Large direct lending managers source and underwrite the majority of their investments through private equity sponsors. Consequently, ~75% of borrowers in direct lending portfolios are sponsor-backed[3], versus only ~15% in bank loan portfolios. This concentration within the sponsor-backed market leads to overlap in borrower exposures and increases common factor risk across larger lenders (*see Box 1*).
- **Liquidity:** Institutional direct lending portfolios are typically illiquid given the use of private drawdown fund structures. This illiquidity has generally been accepted, refelecting the asset class' trade-off bewteen an enhanced risk/return profile and reduced flexibility. This aligns well with institutional ALM frameworks, which favor a buy-and-hold approach. As allocations grow, however, the need for periodic liquidity becomes increasingly relevant to support strategic asset allocation rebalancing, benefit payments, and other liability-driven cash flows.

Box 1 – **Direct Lending "Beta"**

Direct lenders have built a strong position in PE-backed lending through specialization and deep sponsor relationships. However, rapid asset growth has led to intense competition, spread compression, and portfolio convergence.

Sectors: Concentration in industries with high levels of sponsor-backing, such as business services, software, healthcare, technology
Note: only ~5% of U.S. middle market companies are sponsor-backed[4]

Collateral: Borrowers more likely in intangible capital-intensive sectors, relying on all-asset collateral[3], and funding against a firm's enterprise value, instead of the liquidation value of pledged assets

Sponsor Exposure: Deal sourcing through sponsors, not driven by geographic proximity to borrowers, but by industry specialization. Repeat lending relationships with larger sponsors are common.

Portfolio Overlap: High level of exposure convergence across direct lending vehicles (~60% weighted average BDC overlap in Q3-25), driving credit performance correlation[5]

Underwrite Intensity: Rapid-execution, highly competitive model with sponsor-led diligence, larger lender groups, and increasingly weaker, standardized lender protections

Economic Terms: As direct lending scales into larger/syndicated transactions, abundant capital and competition with the BSL market drives spread compression

Large segments of the U.S. economy, outside the private equity ecosystem, continue to be primarily served by banks and finance companies

[3] University of Chicago: "The Lending Technology of Direct Lenders in Private Credit", Jan-2026
[4] National Center for the Middle Market: "Private Equity in the Middle Market", 2025
[5] Raymond James: "3Q25 BDC Portfolio Overlap - Non-Accrual Overlap Ticks Down", 08-December-2025

Bank–private credit partnerships have emerged as an additional channel for C&I direct lending, offering access to a broader universe of middle-market borrowers, sectors, and geographies, and helping to enhance portfolio diversification. At the same time, fund/BDC structures with periodic redemption windows can help address liquidity needs.

U.S. Regional Banks

Regional and community banks are a backbone of the U.S. economy, providing relationship-based credit, deposits, payments, and financial infrastructure to local middle market businesses, agriculture, and real estate enterprises that are less covered by national money-center banks or capital markets. Distributed across the U.S., ~40 commercial banks with balance sheet size of $30-$220 billion serve regional markets. Excluding real estate lending, the segment's aggregate assets are estimated at ~$2.1 trillion[6].

Compared to regional banks, non-bank direct lending has limited reach in industries and areas with low private equity presence. As of 2022, only 2.5% of non-financial middle-market borrowers had a direct loan, versus 41.3% with a bank loan[3].

Figure 2: **Regional Industry Clustering in the U.S.**

Sources: U.S. Bureau of Economic Analysis, PMP Research

Geographic proximity and relationship networks remain important in middle-market lending, providing access to differentiated opportunities and reducing information asymmetries, which can enhance underwriting and risk selection.

By nature of their franchises, regional banks provide access to a distinct borrower base compared with sponsor-driven direct lenders. Their more geographically focused origination gives them an

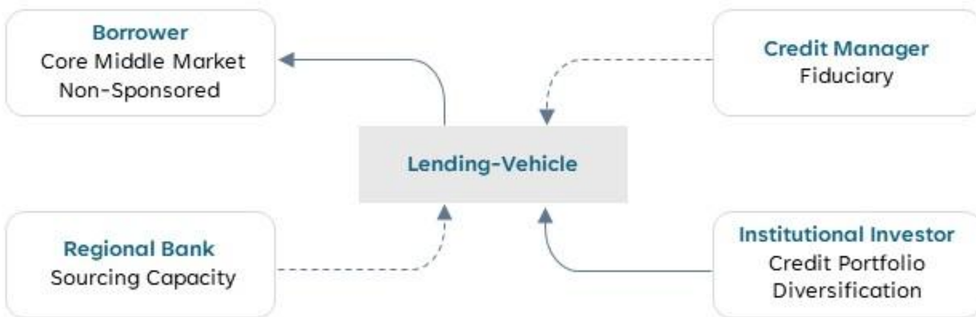
[6] PMP Research: U.S. Federal Reserve System data analysis, March-2026

advantage in serving the sector mix of their regional economies (*see Figure 2*), while large direct lenders tend to maintain sector concentrations shaped by private equity activity.

Regional Bank Partnerships – A Paradigm Shift in Direct Lending

Per our analysis, bank-private credit partnerships (*see Figure 3*) represent a new paradigm in C&I middle market lending, providing financing to an underserved borrower segment. As a result they have potential to provide several distinct advantages to all parties involved.

Figure 3: **Bank-Private Credit Partnership Model**



Source: Phoenix Merchant Partners

Institutional Investor	Investors can gain access to differentiated, non-sponsor-backed C&I credit portfolios with lower correlation to typical direct lending strategies, enhancing diversification and supporting efficient portfolio construction across the SAA
Borrowers	By targeting regions and sectors with limited or localized private equity activity, partnerships address a financing gap for core middle-market companies (*see Box 2*), enabling them to leverage banking relationships and access private credit where sources of capital may be constrained
Regional Banks	Sourcing partnerships with long-term, private lenders may effectively create and “originate-and-distribute” model, enabling regional banks to decouple loan origination from balance-sheet retention, increasing capital velocity and generating recurring fee income. *Note: Banks can maintain their regional client franchise around core banking services, while broadening client engagement through expanded financing capacity.*
Credit Managers	Private credit managers can gain access to proprietary deal flow, enhancing selectivity, while capturing cost and operational synergies across loan origination. By addressing financing needs in segments where banks face structural limitations, partnerships can complement the banking system.

Liquidity Considerations

To meet the growing demand among institutional investors for periodic liquidity, these partnerships are typically structured as evergreen Business Development Companies (BDCs) rather than traditional closed-end drawdown vehicles. The BDC framework combines redemption windows with (i) mandatory income distributions, (ii) tax-efficient pass-through treatment at the entity level, and (iii) a robust regulatory framework with clearly defined governance and investment guidelines.

Although the underlying C&I loan portfolio is expected to remain illiquid, regular income distributions together with quarterly redemption offers of up to 5% of NAV, may provide investors with periodic liquidity, equivalent to ~25-30% of NAV annually. This is intended to support the typical cash flow, distribution, and portfolio rebalancing needs of many institutional investors.

Box 2 – **Commercial Bank Leveraged Lending**

Regional banks typically operate business models centered on short- to medium-duration lending and highly liquid balance sheets. They focus on working capital facilities, risk management solutions, and fee-generating businesses such as transaction banking, treasury services, and cash management. These priorities result from structural constraints on

Capital: Post-GFC Basel III rules increased the capital intensity of unrated, high-yield, middle-market loans. Combined with balance-sheet leverage ratio these changes reduced the RORC for such credit exposures

Liquidity: Asset-Liability Management rules, incl. requirements to hold high-quality liquid assets (HQLA), and the Net Stable Funding Ratio limiting maturity mismatches, increased the costs associated with longer-duration, illiquid loans

Supervision: The 2013 Interagency Guidance on Leveraged Lending imposed strict leverage and repayment capacity requirements, increasing the regulatory burden on loans that rely on refinancing to achieve deleveraging[7]

Within this framework banks have limited ability to provide longer-duration, more leveraged, or less liquid forms of financing.

Risk Profile and Portfolio Allocation

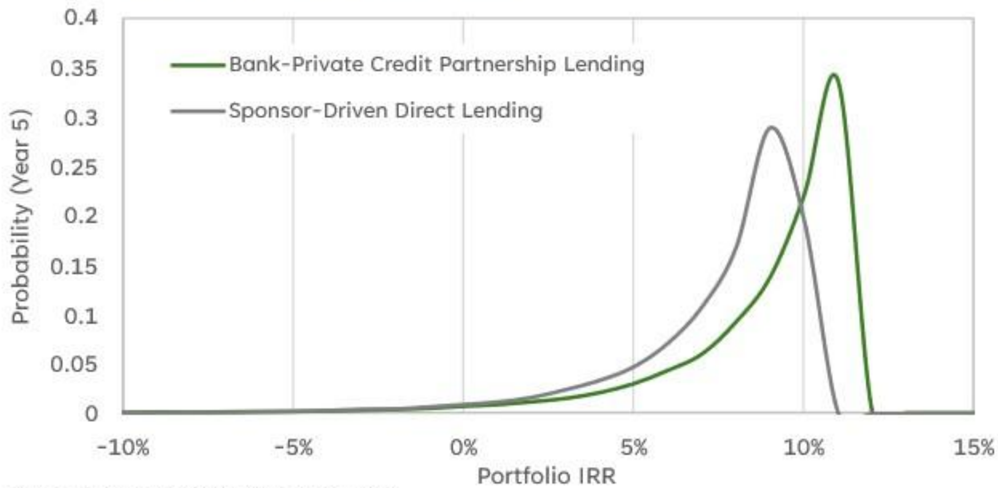
The origination framework and dynamics associated with bank–private credit partnerships give rise to portfolios that are structurally differentiated from traditional direct lending portfolios (*see Box 1*) across several dimensions.

Industry Sector	Broader core middle market exposure to “Main Street” industries, including sectors such as manufacturing, distribution, transportation, construction services
Collateral	Enhanced access to tangible collateral, including fixed assets, receivables, and inventory
Sponsor Exposure	Focus on proprietary, directly originated non-sponsor deal flow within priority geographies, supplemented by selective engagement with regional sponsors
Portfolio Overlap	Proprietary, often sole-lender transactions, creating idiosyncratic portfolios with limited overlap to the broader direct lending market
Underwrite Intensity	Disciplined private credit underwriting, informed by bank’s borrower relationship and proprietary insights, focusing on strong covenants and bespoke lender protections
Economic Terms	Core middle market focus and less commoditised opportunities support stronger economics than sponsor-backed upper middle market lending

[7] Note: Despite the OCC and FDIC having rescinded the Interagency Guidance on Leveraged-Lending in Dec-2025, capital, liquidity, and leverage rules continue to affect banks’ appetite for holding illiquid, unrated middle-market loans on balance-sheet

The potential diversification benefits of partnership portfolios can be incorporated into a strategic asset allocation framework by considering two distinct categories within C&I middle-market lending. The model projection in Figure 4 illustrates the expected differences in risk-return properties between (a) existing direct-lending portfolios and (b) bank–private credit partnership portfolios.

Figure 4: **Model Portfolio Return Distribution**



Source: Phoenix Merchant Partners Research

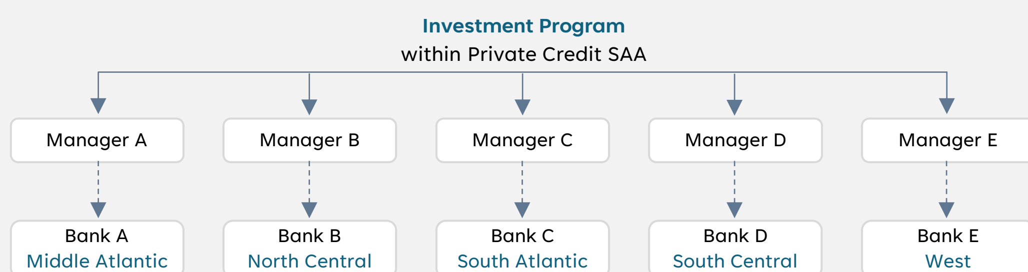
Broader diversification across sectors, combined with lower expected default risk resulting from stronger covenant protection and higher anticipated recovery supported by tangible collateral, moves the bank-partnership portfolio towards the risk efficient frontier. At the same time, enhanced economics, driven by lower capital crowding, support higher expected returns.

A more balanced allocation between sponsor-driven and regional bank–sourced credit has the potential to improve diversification within direct-lending portfolios. When implemented through a scalable investment program (*see Box 3*), supported by an appropriate governance framework and operating model, this new paradigm can help institutional investors reduce concentration risk and common factor exposure.

Box 3 – **Scale Considerations**

Scalability of a regional bank partnership program depends largely on private credit manager's operational capacity to integrate effectively with commercial banking platforms.

The geographic footprint of bank partnerships is a key determinant of portfolio diversification, with a multi-bank framework offering the potential to mitigate regional concentration risk.



A matrix structure can limit exposure to any single regional bank's sourcing pipeline and insulate the institutional portfolio from localized economic shocks

Conclusion

Direct lending has grown rapidly as an asset class over the past decade, driven largely by increasing institutional allocations. However, as the market continues to scale through a private equity–driven lending model, challenges related to diversification and liquidity provision are emerging.

Existing direct lending portfolios, shaped by the financing needs of sponsors, exhibit concentration and significant overlap in certain sectors and business models, while capital crowding and heightened competition have reduced differentiation among managers.

Bank–private credit partnerships create access to a differentiated origination channel, resulting in portfolios that differ from direct-lending in sector composition, collateral quality, and underwriting intensity. Their focus on core middle-market borrowers and regional sourcing tends to reduce competitive pressure, supporting stronger economics and lender protections.

A strategic asset allocation framework that balances sponsor-driven and bank-sourced credit can capture the diversification benefit of these complementary lending strategies, enhancing the risk-return efficiency of a direct-lending portfolio.

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